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SUBJECT: SENEGAL: 2006 BUDGET CONTINUES TO FOCUS ON THE
SOCIAL SECTOR

DAKAR 00000933 001.2 OF 006

¶1. (SBU) SUMMARY: Senegal's 2006 budget allocates more money to the social sector (education and health), and relies on CFA francs (CFAF) 43.1 billion (USD 78.3 million) in savings from the Heavily Indebted Poor Countries (HIPC) debt relief initiative to reduce poverty, which affects nearly 57 percent of the population. The 2006 budget projects domestic revenue of CFAF 926 billions (USD 1.68 million) -- 9.1 percent higher than the 2005 budget revenues. The 2006 projection assumes a broader tax base, which the Government of Senegal (GOS) optimistically projects will increase by 21.1 percent to reach CFAF 508.2 billion (USD 924 million) or 54.8 percent of total internal revenue. Budgeted expenditures for 2006 are CFAF 1,407.8 billion (USD 2.56 billion) -- just over 9.1 percent higher than 2005 budget level, leaving a CFAF 22 billion (USD 40 million) gap, which the Senegalese hope to close with additional grants and foreign loans. About 22.3 percent of Senegal's 2006 budget revenues will come from foreign transfers, a slight drop from 2005 levels. The budget estimates 2006 GDP growth to remain at 5 percent, a number that is significantly below the 7.5 percent growth needed to alleviate poverty and boost economic development by 2015, as envisioned in the government's Accelerated Growth Strategy. Moreover, some economists are predicting that energy shortages could cut 2006 GDP growth to just three percent. END SUMMARY.

HEFTY INCREASE PLANNED IN EXPENDITURES

¶2. (U) The 2006 budget projects total expenditures and net borrowing of CFAF 1,407.8 billion (USD 2.56 billion), including expenditures financed with HIPC resources of CFAF 43.1 billion (USD 78 million), an increase of 9.1 percent from 2005's CFAF 1,293.0 billion (USD 2.34 billion). This is mainly due to a significant, 17-percent increase in other expenditures, which include subsidies of CFAF 9 billion to Sonacos (the recently privatized peanut oil plant), CFAF 25 billion for social welfare spending (to include subsidies for butane gas bottles), a seven percent increase in the civil service wage bill, and a 4.7 percent increase in GOS's contribution to capital investment. The operating budget, which excludes debt service and capital investments, for 2006 has been set at

CFAF 628 billion (USD 1.14 billion), up 12 percent from
¶2005. New measures include CFAF 9 billion (USD 16 million) to hire 5,000 school teachers, health workers and Ministry of Justice officials; CFAF 29 billion (USD 52 million) for operating costs; and CFAF 34.4 billion (USD 62.5 million) in other expenditures.

DEBT SERVICE BURDEN DECREASES

¶3. (U) The GOS increased budgeted expenses under the "Treasury Special Accounts" (TSA) by two percent. This category consists of special funds to support various government commitments, including investment guarantees, water resource management and environmental resource funds. As opposed to previous years, this year the majority of TSA represent relatively small amounts that are financed by earmarked taxes. Other important categories such as the "National Retirement Fund and the "Caisse Autonome d'Amortissements" (CAA) (the account used to service public debt) have been withdrawn from the TSA and are now part of the general budget, a positive move towards greater transparency. In 2006, expenditures out of the CAA are budgeted at CFAF 119 billion (USD 216 million), an increase of seven percent over 2005 levels. The G-8 debt relief package initiative, other debt forgiveness, debt rescheduling and tight controls on new debt issuance within Senegal's IMF program have all contributed to the reduction of Senegal's debt service burden.

OPERATING BUDGET DOMINATED BY PERSONNEL COSTS

¶4. (U) Current expenditures (Table 3) for 2006 have been set at CFAF 627.8 billion (USD 1.14 billion), up 12.2 percent from the 2005 level of CFAF 559.1 billion (USD 1.02 billion). The breakdown of the budget by economic categories (Table 4) reveals the predominance of personnel

costs (42.4 percent) in the government's operating expenditures. Though the wage bill is expected to increase by seven percent due to plans to hire teachers and health workers, completing the GOS's HIPC commitment to recruit 15,000 workers between 2003-2006), as well as workers for the Ministry of Justice, its ratio over tax revenues (29 percent) remains within the limits established by the IMF program, which caps the GOS's personnel costs at 35.5 percent of total revenues (CFAF 926.5 billion or USD 1.68 billion under 2006 revenue projections). (COMMENT: The GOS's wage bill might be underestimated and might not include the recent salary increases for magistrates. END COMMENT.) Of the CFAF 43.1 billion collected from HIPC savings, CFAF 4.1 billion and CFAF 4.4 billion will be used respectively to improve the operating expenditures for education and health. The remaining CFAF 34.5 billion will be used for building more schools (CFAF 5 billion), more health centers (CFAF 4 billion), infrastructure projects (CFAF 10 billion), agriculture projects (CFAF 4.7 billion), family welfare projects (CFAF 3 billion), sewerage projects (CFAF 3 billion), environmental projects (CFAF 2.3 billion), trade projects (CFAF 1,1 billion) and increasing available credit to women in rural areas (CFAF 1 billion).

¶5. (U) An examination of the budget allocations by function (Table 5, para 17) clearly highlights GOS's efforts to improve and sustain education and health and further the poverty alleviation process by empowering local communities. The Ministry of Education will continue to have nearly 40 percent of the operating budget at its disposal, 42 percent (CFAF 106.8 billion or USD 194 million) of which will be spent on personnel costs, while devoting 17 percent (CFAF 44.1 billion or USD 81 million) to building new classrooms, broadening access to primary education, and hiring new teachers.

¶6. (U) While health spending as a percentage of the budget declined somewhat in comparison to 2005, health spending remains significant at 10.5 percent of the operating budget or CFAF 80.5 billion (USD 146 million), which is higher than the nine percent established as a benchmark by the World Health Organization. Twenty six percent or CFAF 21.1 billion (USD 38 million) of health allocations will be spent on personnel costs, while 34.5 percent will be used to build hospitals and fund additional health workers.

¶7. (U) The Ministry of Armed Forces' budget allocation increased by 18.4 percent, reflecting a 115 percent increase in program funding (training exercises, building and equipment) and 33 percent in supplies. Despite these increases, the military's share of the operating budget remained essentially constant at 9.2 percent due to its disengagement from the Casamance region. The budget for the Ministry of Interior also increased by 15.6 percent to take into account the preparation of the upcoming presidential and legislative elections. To further the decentralization process, the GOS appropriated CFAF 17.4 billion (USD 32 million) for decentralization. Justice and Environment are the apparent big winners with increases of 68 percent and 61 percent in their respective budgets. The increases are largely for personnel and investments in the new court house, which is set to open in 2007, and deforestation projects. The Ministry of Economy and Finance's budget also went up.

BROADER TAX BASE AND INCREASED REVENUES

¶8. (U) The operating budget, the first of three basic components of Senegal's fiscal plan (Table 1) projects total general revenues of CFAF 1,344.2 billion (USD 2.44 billion) in 2006, an increase of 9.3 percent over the previous year. The GOS estimates it can reach this goal by increasing tax revenue by 9.1 percent to CFAF 876 billion (USD 1.5 billion). The GOS envisions meeting that goal through more effective collection of existing taxes and a broadening of the tax base, especially of the value added tax (VAT). (COMMENT: Broadening the tax base has been an important element of Senegal's IMF Poverty

Reduction and Growth Facility (PRGF) program, to which Wade's government is committed. The Ministry of Finance is encouraging the informal sector and property owners to register their businesses and pay taxes with the "slogan" of one tax paid could contribute to the education of a full generation of kids. END COMMENT.)

¶9. (U) The budget shows a continued decline in Senegal's dependence on duties, which are expected to fall 11.8 percent in 2006 even as customs collections increase. Duties will drop from 16 to 13 percent of total tax revenue, despite the planned establishment of import duties of 25 percent on palm oil and 15 percent on the import of other vegetable oils. (COMMENT: Discussions are ongoing between the World Bank and the GOS as these duties are inconsistent with WTO commitments. END COMMENT.) Other indirect taxes such as VAT and consumption taxes are set to increase by 13.4 percent, reaching almost 57 percent of tax revenues. Despite the 25 percent reduction of the corporate income tax, GOS projects that direct taxes (e.g. income and corporate taxes) will increase by 4.2 percent. Direct taxes still account for less than a quarter of tax revenues.

¶10. (U) Non-tax revenues, which include revenues from maritime activities, industrial enterprises, miscellaneous services and investments, are expected to decrease by 3.6 percent in 2006, following the termination of counterpart payments for the fishing agreement with the EU (to be renegotiated by May 2006). (COMMENT: The GOS expects to revise the 2006 budget to reflect the changes in non-tax

revenues once the new fishing agreement with the EU is signed and once the third cellular telephone telecommunications license is sold. END COMMENT.)

FOREIGN AID REMAINS STABLE OR INCREASES

¶11. (U) In contrast, CFAF 417 billion (USD 758.1 million) in external revenue is expected to be collected from donors. Of this amount, CFAF 293.0 billion (USD 532.7 million) will come from foreign sources to support GOS investment program; CFAF 75 billion will come from debenture loans; CFAF 37 billion will come from multilateral/bilateral programs; and CFAF 12.6 billion will derive from budget grants.

¶12. (U) Foreign assistance is expected to remain stable at 22.3 percent (Table 2, para 17) of overall government financing in 2006. The projected need for foreign assistance is CFAF 315.0 billion, with CFAF 22 billion to cover the financing gap, and CFAF 293 billion for the government's investment program. The Government hopes to bridge the CFAF 22 billion gap through a variety of bilateral and multilateral grants and loans.

PUBLIC INVESTMENT PLAN DEPENDS ON FOREIGN INVESTMENT
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¶13. (U) For 2006, the government investment plan is set at CFAF 613.3 billion (USD 1.13 billion), compared to CFAF 575.9 billion (USD 1.04 billion) in 2005 -- a 6.4 percent increase. The investment budget assumes that GOS resources of CFAF 320.3 billion will be supplemented by external financing of CFAF 293.0 billion. In 2006, foreign financing will cover just 48 percent of the investment program, with 65 percent as loans and the rest as grants. The 2006 investment program focuses particularly on social services infrastructure (roads, water, health and education) at 64 percent of total investment, followed by the service sector (tourism, trade, transport and telecommunications) at 19 percent. The primary sector (agriculture) will receive 13 percent, and the manufacturing sector (industries and mining) three percent of total investment.

BUDGET PART OF A STABLE MACROECONOMIC FRAMEWORK
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¶14. (SBU) For 2006, the GOS projects continued stable macroeconomic growth with a real GDP growth rate of 5 percent and an annual inflation rate of 2.5 percent due to increases in oil and electricity prices. Strong private

remittances will help maintain the external current account deficit at about 7.6 percent of GDP. The overall fiscal deficit, including grants, is expected to increase from 3.5 percent of GDP in 2005 to 4 percent of GDP in ¶2006. (COMMENT: The GOS's real GDP growth for 2006 is likely to fall short of expectations as the result of chronic, long and unscheduled power outages. Septel addresses the energy crisis and its economic implications. However, some economists predict that annual GDP growth may be as low as three percent -- half of what it was in 2003-2005. END COMMENT.)

¶15. (U) Given its track record of stable macroeconomic performance since 1994, and considering its upcoming "graduation" from the IMF's PRGF on April 27, 2006, the GOS would like to continue its close collaboration with the IMF through a non-financial Policy Monitoring Arrangement, focusing on accelerated growth, poverty reduction and deepening fiscal and financial sector reforms.

COMMENT

¶16. (SBU) While most donors view the PMA favorably, the French fear that any arrangement that does not include

benchmarks and strong monitoring from the IMF could lead to the collapse of Senegal's macroeconomic stability.

¶17. (SBU) It is difficult to say whether Senegal has successfully implemented its post-HIPC debt relief program in alleviating poverty. According to the second PRGF progress report published in June 2005, poverty indices demonstrate a reduction from 57 percent to 54 percent between 2001 and 2004. Other key measures to be implemented in the short- to medium-term, such as reducing the rapid population growth rate and the rate of rural-to-urban migration, increasing employment and improving credit access in rural areas term remain difficult.

¶18. (SBU) While donor support will likely be forthcoming for this transitional period after its graduation from PRGF, Senegal will have to commit to deeper economic reforms that will improve its business climate. This will be a particularly challenging assignment with the upcoming February 2007 elections. Pressure will undoubtedly mount to ignore difficult economic and social reforms and to distinguish between spending on government programs and political campaign promises. Wade's government will be put to the test in resisting political interference that, in past elections years with the former ruling Socialist Party government in power, had a severely negative impact on the economy. END COMMENT.

TABLE 1: 2006 BUDGET (BILLIONS OF CFAF)

	2006 BUDGET	2005 BUDGET	PCT CHANGE 06-05
¶I. ORDINARY BUDGET			
¶A. Total Revenues	1,344.2	1,229.5	9.3
(1) Internal Revenues	926.5	849.2	9.1
Direct Tax	226.0	200.0	13.0
Indirect Taxes	650.0	602.2	7.9
--Of Which:			
---Trade Tax	120.0	136.2	(11.8)
---Vat	508.2	448.0	13.4
---Stamp/Registration Tax	21.8	18.0	21.1
Non-tax Revenue	42.4	38.9	9.0
Extraordinary Revenue	0.1	0.1	0.0
Other Revenue	8.0	8.0	0.0
(2) External Revenues	417.6	380.3	9.8
Budget Grants	12.6	29.1	(56.7)
-Programs	37.0	10.3	259.2
Debenture Loan	75.0	74.0	1.3
Other External Revenues	293.0	266.9	9.7

	2006 BUDGET	2005 BUDGET	PCT CHANGE 06-05
¶B. Total Expenditures	1,360.6	1,246.6	
Ordinary Expenditures	627.8	559.1	
--Of Which:			
---Salaries	266.3	249.3	6.8
---Other	361.5	309.8	16.6
----Subsidies Senelec/Sonacos			
Capital Expenditure	613.3	575.9	6.4
--Of Which:			
---Internal (GOS)	320.3	309.0	3.6
---External (Donors)	293.0	266.9	9.7
Public Debt	119.5	111.6	7.0
II. SPECIAL TREASURY ACCOUNTS			
¶A. Earmarked Revenue	41.7	40.9	1.9
¶B. Liabilities And Entitlements	47.2	46.4	1.7

III. GRAND TOTAL

¶A. Revenues	1,385.8	1,270.4	9.0
¶B. Expenditures	1,407.8	1,293.0	8.8
¶C. Financing Gap	(22.0)	(22.4)	

TABLE 2: FOREIGN FINANCING (BILLIONS OF CFAF)

	GRANTS	LOANS	TOTAL
Financing Gap (Table 1)			22.0
Total Foreign Investment	101.0	191.8	293.0
Total Foreign Financing			315.0

TABLE 3: 2006 BUDGET EXPENSE SUMMARY (BILLION OF CFAF)

Overall Budget Summary	CFAF	Pct Of Total
Operating Expenses	627.8	44.5
--Of Which: Financing Gap	22.0	
Debt Service/Entitlements	166.7	11.8
Government Capital Investment	320.3	22.7
Foreign Capital Investment	293.0	21.0
Total Budget	1,407.8	100.0

TABLE 4: OPERATING EXPENSES BY CATEGORY (BILLIONS OF CFA)

Expense Category	Ordinary Expend.	New Measures	Total Expend.	Pct Of Total
Personnel	257.1	9.2	266.3	42.4
Equipment	168.5	28.7	197.2	31.4
Programs	129.7	34.5	164.2	26.2
Total	555.3	72.4	627.7	100.0

TABLE 5: 2006 EXPENSES BY MINISTRY (BILLIONS OF CFAF)

MINISTRY/FUNCTION	2006 BUDGET	PCT GROWTH	PCT OF TOTAL 2006	2005
Education	250.0	6.0	40.0	42.0

MINISTRY/FUNCTION	2006 BUDGET	PCT GROWTH	PCT OF TOTAL 2006	2005
Health	80.5	-9.0	13.0	15.0
Agriculture	114.6	-3.4	18.2	21.1
Infrastructure	94.0	-30.0	15.0	24.0
Armed Forces	77.6	18.3	12.3	11.0
Interior	41.5	15.6	6.6	6.0
Foreign Affairs	28.4	0.4	4.5	5.3
Economy And Finance	109.2	22.4	17.3	16.0
Decentralization	32.6	7.1	5.1	6.4
Justice	20.0	68.0	3.1	2.0
Environment	24.2	61.0	4.0	2.6
All Others	535.2	23.0	38.0	33.6

Source: Data summarized by Embassy from GOS budget

documents.

JACOBS